

§ 242.201

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to satisfy the order to buy, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee, or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee.

(9) The term *trading center* shall have the same meaning as in § 242.600(b)(82).

(b)(1) A trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to:

(i) Prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day; and

(ii) Impose the requirements of paragraph (b)(1)(i) of this section for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.

(iii) *Provided, however*, that the policies and procedures must be reasonably designed to permit:

(A) The execution of a displayed short sale order of a covered security by a trading center if, at the time of initial display of the short sale order, the order was at a price above the current national best bid; and

(B) The execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order is at a price that is less than or equal to the current national best bid.

(2) A trading center shall regularly surveil to ascertain the effectiveness of the policies and procedures required by paragraph (b)(1) of this section and shall take prompt action to remedy deficiencies in such policies and procedures.

(3) The determination regarding whether the price of a covered security has decreased by 10% or more from the

covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day shall be made by the listing market for the covered security and, if such decrease has occurred, the listing market shall immediately notify the single plan processor responsible for consolidation of information for the covered security pursuant to § 242.603(b). The single plan processor must then disseminate this information.

(c) Following any determination and notification pursuant to paragraph (b)(3) of this section with respect to a covered security, a broker or dealer submitting a short sale order of the covered security in question to a trading center may mark the order "short exempt" if the broker or dealer identifies the order as being at a price above the current national best bid at the time of submission; *provided, however*:

(1) The broker or dealer that identifies a short sale order of a covered security as "short exempt" in accordance with this paragraph (c) must establish, maintain, and enforce written policies and procedures reasonably designed to prevent incorrect identification of orders for purposes of this paragraph; and

(2) The broker or dealer shall regularly surveil to ascertain the effectiveness of the policies and procedures required by paragraph (c)(1) of this section and shall take prompt action to remedy deficiencies in such policies and procedures.

(d) Following any determination and notification pursuant to paragraph (b)(3) of this section with respect to a covered security, a broker or dealer may mark a short sale order of a covered security "short exempt" if the broker or dealer has a reasonable basis to believe that:

(1) The short sale order of a covered security is by a person that is deemed to own the covered security pursuant to § 242.200, provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.

(2) The short sale order of a covered security is by a market maker to offset customer odd-lot orders or to liquidate an odd-lot position that changes such

broker's or dealer's position by no more than a unit of trading.

(3) The short sale order of a covered security is for a good faith account of a person who then owns another security by virtue of which he is, or presently will be, entitled to acquire an equivalent number of securities of the same class as the securities sold; provided such sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from a current difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such securities of the issuer.

(4) The short sale order of a covered security is for a good faith account and submitted to profit from a current price difference between a security on a foreign securities market and a security on a securities market subject to the jurisdiction of the United States, provided that the short seller has an offer to buy on a foreign market that allows the seller to immediately cover the short sale at the time it was made. For the purposes of this paragraph (d)(4), a depository receipt of a security shall be deemed to be the same security as the security represented by such receipt.

(5)(i) The short sale order of a covered security is by an underwriter or member of a syndicate or group participating in the distribution of a security in connection with an over-allotment of securities; or

(ii) The short sale order of a covered security is for purposes of a lay-off sale by an underwriter or member of a syndicate or group in connection with a distribution of securities through a rights or standby underwriting commitment.

(6) The short sale order of a covered security is by a broker or dealer effecting the execution of a customer purchase or the execution of a customer "long" sale on a riskless principal basis. In addition, for purposes of this paragraph (d)(6), a broker or dealer must have written policies and procedures in place to assure that, at a minimum:

(i) The customer order was received prior to the offsetting transaction;

(ii) The offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and

(iii) The broker or dealer has supervisory systems in place to produce records that enable the broker or dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which a broker or dealer relies pursuant to this exception.

(7) The short sale order is for the sale of a covered security at the volume weighted average price (VWAP) that meets the following criteria:

(i) The VWAP for the covered security is calculated by:

(A) Calculating the values for every regular way trade reported in the consolidated system for the security during the regular trading session, by multiplying each such price by the total number of shares traded at that price;

(B) Compiling an aggregate sum of all values; and

(C) Dividing the aggregate sum by the total number of reported shares for that day in the security.

(ii) The transactions are reported using a special VWAP trade modifier.

(iii) The VWAP matched security:

(A) Qualifies as an "actively-traded security" pursuant to § 242.101 and § 242.102; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than 5% of the value of the basket traded.

(iv) The transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.

(v) A broker or dealer shall be permitted to act as principal on the contra-side to fill customer short sale orders only if the broker's or dealer's position in the covered security, as committed by the broker or dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume.

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(e) No self-regulatory organization shall have any rule that is not in conformity with, or conflicts with, this section.

(f) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any person or class of persons, to any transaction or class of transactions, or to any security or class of securities to the extent that such exemption is necessary or appropriate, in the public interest, and is consistent with the protection of investors.

[75 FR 11323, Mar. 10, 2010, as amended at 83 FR 58427, Nov. 19, 2018]

§ 242.203 Borrowing and delivery requirements.

(a) *Long sales.* (1) If a broker or dealer knows or has reasonable grounds to believe that the sale of an equity security was or will be effected pursuant to an order marked “long,” such broker or dealer shall not lend or arrange for the loan of any security for delivery to the purchaser’s broker after the sale, or fail to deliver a security on the date delivery is due.

(2) The provisions of paragraph (a)(1) of this section shall not apply:

(i) To the loan of any security by a broker or dealer through the medium of a loan to another broker or dealer;

(ii) If the broker or dealer knows, or has been reasonably informed by the seller, that the seller owns the security, and that the seller would deliver the security to the broker or dealer prior to the scheduled settlement of the transaction, but the seller failed to do so; or

(iii) If, prior to any loan or arrangement to loan any security for delivery, or failure to deliver, a national securities exchange, in the case of a sale effected thereon, or a national securities association, in the case of a sale not effected on an exchange, finds:

(A) That such sale resulted from a mistake made in good faith;

(B) That due diligence was used to ascertain that the circumstances specified in § 242.200(g) existed; and

(C) Either that the condition of the market at the time the mistake was

discovered was such that undue hardship would result from covering the transaction by a “purchase for cash” or that the mistake was made by the seller’s broker and the sale was at a permissible price under any applicable short sale price test.

(b) *Short sales.* (1) A broker or dealer may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker or dealer has:

(i) Borrowed the security, or entered into a bona-fide arrangement to borrow the security; or

(ii) Reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and

(iii) Documented compliance with this paragraph (b)(1).

(2) The provisions of paragraph (b)(1) of this section shall not apply to:

(i) A broker or dealer that has accepted a short sale order from another registered broker or dealer that is required to comply with paragraph (b)(1) of this section, unless the broker or dealer relying on this exception contractually undertook responsibility for compliance with paragraph (b)(1) of this section;

(ii) Any sale of a security that a person is deemed to own pursuant to § 242.200, provided that the broker or dealer has been reasonably informed that the person intends to deliver such security as soon as all restrictions on delivery have been removed. If the person has not delivered such security within 35 days after the trade date, the broker-dealer that effected the sale must borrow securities or close out the short position by purchasing securities of like kind and quantity;

(iii) Short sales effected by a market maker in connection with bona-fide market making activities in the security for which this exception is claimed; and

(iv) Transactions in security futures.

(3) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a threshold security for thirteen consecutive settlement days, the participant shall immediately thereafter close out the fail to deliver position by